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SUBJECT: Growth Returns to Guangdong with Rising Domestic Demand and
Ongoing Efforts at Industrial Upgrading

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11. (SBU) Summary: Officials in Guangdong are declaring victory over
the global financial crisis's impact on the trade-dependent
province's economy. They point to projections that growth for the
province will exceed 8% for the year after falling to a 30-year low
in the first quarter. Our contacts attribute much of the success to
the government's stimulus package and rising local demand. However,
officials and business leaders alike acknowledge that state-owned
enterprises (SOEs) have benefitted disproportionately from the
stimulus and more needs to be done for (SMEs). Guangdong's efforts
to move labor-intensive industries out of the Pearl River Delta
(PRD) to make room for more advanced industries have continued and
will likely strengthen as the economy continues to improve. End
summary.

Growth Returning to Guangdong

12. (SBU) After the chilling effect of the global economic downturn
on Guangdong's trade-dependent economy, growth is returning with
vigor to the province, according to local government, academic and
business contacts. Guangdong Development and Reform Commission
(GDDRC) Deputy Director Cai Yunge recently explained to the
Minister-Counselor for Economic Affairs visiting from Beijing that
2009 first quarter growth was just 5.8% -- almost nine percentage
points lower than the provinces growth in 2007 and the lowest rate
in the past 30 years. The impact of the global downturn was
particularly severe in Guangdong because the province relies so
heavily on trade, Cai said. He pointed out that Guangdong's total
foreign trade was 155% of the province's GDP in 2007, 89 percentage
points higher than China as a whole. Moreover, Cai noted that the
U.S. market, which suffered dramatically from the downturn,
accounted for 40% of Guangdong's exports. But the resurgence in
growth has been strong. Cai said Guangdong's growth in the third
quarter reached 8.6%. Guangdong Academy of Social Science (GDASS)
President Liang Guiquan told the Consul General on December 4 that
he expected the province's growth to be 8.5% for the year overall.

13. (SBU) Businesses in the province also report improving performance. American Chamber of Commerce in South China President Harley Seyedin told us that power consumption in the province had rebounded since April, orders for member companies were improving and that the local labor market was showing signs of shortages again. Seyedin highlighted that one foreign-invested manufacturer of electronic components had recently announced that it would hire 6,000 new workers due to increased orders and another 10,000 after the Lunar New Year holiday in February 2010. FedEx separately told us that cargo volumes at its Guangzhou Asia-Pacific hub were returning to to pre-downturn levels. Guangzhou-based China Southern Airlines Chief Economist said that the firm expected its revenue growth for the year to be 10.8%.

Taking Steps to Stimulate Demand

14. (SBU) Stimulating domestic demand has been a key component of the province's strategy emphasized by provincial government interlocutors. GDDRC's Cai claimed that Guangdong was ahead of most provinces in its programs to increase demand. No effort had been spared to promote sales of automobiles, household appliances, real estate and information technology products, according to Cai, who pointed out that retail sales in the province had gone up 16.2% from January through October 2009. He also reported that the province would allocate RMB 2.37 trillion (about US\$350 billion) for 222 investment projects from 2008 to 2015. For the first ten months of 2009, investment had already totaled RMB 303 billion (about US\$45 billion), he said. GDASS's Liang echoed Cai's comments on the province's efforts to increase demand. Noting the strong increase in retail sales, he said consumers were willing to spend despite the global financial crisis. Liang also explained that much of the

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government's investment spending was going toward infrastructure development. He believes the next stage for efforts to stimulate demand should be directed toward SMEs, which create more employment.

15. (SBU) However, Standard Chartered Branch Manager Irving Law called for additional action. He argued that expanding domestic consumption would require changing the habits of Chinese people to save less and spend more. The government needs to reform pension schemes and the medical care system to make people feel more secure, according to Law. He believes that further expansion of domestic consumption is critical to China's economy because U.S. demand for China's exports going forward will not be sufficient to drive growth the way it did in the past.

SOEs Benefit at SMEs' Expense

16. (SBU) Many observers in south China continue to point out that stimulus policies have favored SOEs at the expense of struggling SMEs. Guangzhou Academy of Social Sciences (GZASS) President Li Jiangtao told us that most of the money in the stimulus money went to SOEs because they were seen as a safer investment. However, Li identified local efforts aimed at addressing the problem: the Guangzhou municipal government is working on a plan to select one high-tech enterprise from each district in the city to receive RMB 5 million (about US\$740 million) in support. (Comment: Li indicated that SOEs would also be eligible to apply for the support, suggesting that, depending on implementation, this measure may not do much to fix the imbalance. End comment.) GDASS's Liang also emphasized the need to encourage SME growth, noting that the city of Foshan had seen 13% growth this year in part because of the strong contribution from SMEs. But Liang did not elaborate on what local governments should do to promote the sector.

17. (SBU) Standard Chartered's Law argued that SOEs did not have enough good projects to fully absorb stimulus funding. He speculated that much of the money had gone into real estate and the stock market, raising the risk of bubbles. Law said that SMEs continue to have difficulty finding financing, estimating that only one-third have formal relationships with commercial banks. The

other two-thirds, he said, rely on underground banks or apply for personal loans in the name of the owner.

Moving up the Value Chain

18. (SBU) Guangdong will use the impact of the global economic downturn to further drive efforts to upgrade industry in the PRD, according to GDASS President Liang. Cai of the GDDRC emphasized successful efforts to upgrade Guangdong's industries that had had a positive environmental impact. He explained that Guangdong had closed inefficient, heavy-polluting steel mills with total capacity of almost 10 million tons in 2009 so far, as well as cement plants with 43 million tons of capacity and heavy-polluting power plants capable of generating 10.8 megawatts of electricity. Although Standard Chartered's Law suggested that industrial upgrading efforts and Guangdong Party Secretary Wang Yang's complementary "double transfer" policy to move labor-intensive, low-tech industry out of the PRD had been placed on the back burner during the downturn, he believes they will take priority again as the economy rebounds.

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